

# **Report of the auditor-general to the Limpopo provincial legislature and the council on Ephraim Mogale Local Municipality**

## **Report on the financial statements**

### **Introduction**

1. I have audited the financial statements of the Ephraim Mogale Local Municipality set out on pages xxx to xxx, which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2015 (Act No. 1 of 2015) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the municipality's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

## Basis for qualified opinion

### Property, plant and equipment

6. The municipality did not recognise all items of property, plant and equipment in accordance with GRAP 17, *Property, plant and equipment*. I identified infrastructure, plant and machinery belonging to the municipality that was not included in the underlying records, as the municipality did not have adequate systems. There were no satisfactory alternative means that I could perform to quantify the extent of the understatement of property, plant and equipment stated at R803 262 197 (2015: R793 217 685) as per the statement of financial position. Additionally, there is a resultant impact on the accumulated surplus.
7. The municipality did not adequately review the residual values and useful lives of property, plant and equipment at each reporting date in accordance with GRAP 17, *Property, plant and equipment*. I identified assets with a zero net carrying value that are still in use. Furthermore, I identified land and buildings included in the underlying accounting records with a gross carrying amount of zero. I was not able to determine the impact on the net carrying amount of property, plant and equipment stated at R803 262 197 (2015: R793 217 685) as per the statement of financial position as it was impracticable to do so. Additionally, there is a resultant impact on the accumulated surplus.

### Investment property

8. The municipality recognised items that did not meet the definition of investment property in accordance with GRAP 16, *Investment property*. I identified owner occupied properties that were recorded as investment property instead of property, plant and equipment. Furthermore, I identified land that was recorded as investment property instead of inventory. There were no satisfactory alternative means that I could perform to quantify the extent of the overstatement of investment property of R57 562 700 (2015: R51 773 000) in the financial statements. Additionally, there is a resultant impact on property, plant and equipment, inventory, surplus for the period and the accumulated surplus.
9. I was unable to obtain sufficient appropriate audit evidence for the restatement of the corresponding figure for investment property. As described in error number eight of note 43 to the financial statements, the restatement was made to rectify a prior year misstatement, but the restatement could not be substantiated by supporting audit evidence for an amount of R34 352 000. I was unable to confirm the restatement by alternative means. Consequently, I was unable to determine whether any adjustment to the investment property corresponding figure stated at R51 773 000 in the financial statements was necessary.

## Cash and cash equivalents

10. I was unable to obtain sufficient appropriate audit evidence to support bank reconciling items amounting to R12 299 399 (2015: R12 318 181) in respect of cash and cash equivalents, as the municipality did not have adequate systems in place. I could not confirm the reconciling items by alternative means. Consequently, I was unable to determine whether any adjustments to cash and cash equivalents stated at R113 249 023 (2015: R80 804 597) disclosed in the financial statements was necessary.

## Irregular expenditure

11. The municipality made payments in contravention of the supply chain management requirements, resulting in irregular expenditure of R19 760 508 (2015: R26 865 367). As the municipality did not implement and maintain an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective, I was unable to determine the full extent of the understatement by alternative means. Consequently, I was unable to determine whether any further adjustments relating to irregular expenditure disclosed at R113 287 928 (2015: R93 527 420) in the financial statements was necessary.

## Qualified opinion

12. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraph, the financial statements present fairly, in all material respects, the financial position of the municipality as at 30 June 2016 and its financial performance and cash flows for the year then ended, in accordance with SA standards of GRAP and the requirements of the MFMA and DoRA.

## Emphasis of matter

13. I draw attention to the matter below. My opinion is not modified in respect of this matter.

## Material impairments

14. As disclosed in note 30 to the financial statements, material losses to the amount of R3 497 031 were incurred as a result of receivables being doubtful.

## Additional matters

15. I draw attention to the matters below. My opinion is not modified in respect of these matters.

## Unaudited supplementary schedules

16. The supplementary information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. I have not audited this schedule and, accordingly, I do not express an opinion thereon.

## Unaudited disclosure notes

17. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

## Report on other legal and regulatory requirements

18. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

### Predetermined objectives

19. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information of the following selected development priority presented in the annual performance report of the municipality for the year ended 30 June 2016:
  - Development priority 2: Basic service delivery and infrastructure development on pages xx to xx
20. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
21. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
22. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
23. The material findings in respect of the selected development priority are as follows:

### **Priority 2: Basic service delivery and infrastructure development**

#### Usefulness of reported performance information

#### Consistency of objectives, indicators and targets

24. Section 41(c) of the Municipal Systems Act, 2000 (Act No.32 of 2000) (MSA) requires the Integrated Development Plan (IDP) to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 100% of the reported objectives, reported indicators and reported targets

were not consistent with those in the approved integrated development plan. This was due to management not exercising proper oversight responsibility over performance planning and reporting.

### Measurability of indicators and targets

25. The FMPPI requires that performance targets should be specific in identifying the nature and required level of performance and measurable. A total of 17% of important targets were not specific and measurable.
26. The FMPPI requires that performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use. A total of 13% of important indicators were not well defined.

### Reliability of reported performance information

27. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. The reported achievements against planned targets of 11% important indicators were not reliable when compared to the evidence provided.

### **Additional matters**

28. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### Achievement of planned targets

29. Refer to the annual performance report on pages xx to xx for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development priorities reported in paragraphs 28 to 31 of this report.

### Unaudited supplementary information

30. The supplementary information set out on pages xx to xx does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

### **Compliance with legislation**

31. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

## Strategic planning and performance management

32. The performance management system was not adopted by council as required by section 38(a) of the MSA and the *Municipal planning and performance management regulation* (8).
33. Key performance indicators in respect of each of the development priorities and objectives were not set out in the IDP, as required by section 41(1)(a) of the MSA and the *Municipal planning and performance management regulation* 1 and 9(1)(a).
34. The service delivery and budget implementation plan (SDBIP) for implementing the municipality's delivery of municipal services and annual budget did not indicate projections for each month of the revenue to be collected, by source and the operational and capital expenditure, by vote as required by section 1 and 53(1)(c) of the MFMA.
35. The adopted IDP did not reflect and identify the key performance indicators and targets as required by sections 26(i) and 41 of the MSA, as well as regulation 2(1)(e) of the *Municipal planning and performance management regulation*.
36. The key performance indicators set by the municipality did not include indicators on percentage of households with access to basic electricity and solid waste removal] were not set by the municipality as required by section 43(2) of the MSA and the *Municipal planning and performance management regulation* 10(a).

## Annual financial statements

37. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

## Expenditure management

38. Reasonable steps were not taken to prevent irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

## Procurement and contract management

39. Thresholds for local content on designated sectors' procurement were not properly applied in accordance with the requirements of the *Preferential Procurement regulation* 9.

## Revenue management

40. A credit control and debt collection policy was not implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of the MFMA.

## Asset management

41. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.
42. Sufficient, appropriate audit evidence could not be obtained to determine whether or not capital assets permanently disposed were not needed to provide the minimum level of basic municipal service, in contravention of section 14(1) of the MFMA.
43. Capital assets were permanently disposed without the approval of the council, as required by section 14(2)(a) of the MFMA.

## Human resource management and compensation

44. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor, measure and evaluate performance of staff in contravention of section 67(d) of the MSA.

## Consequence management

45. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.
46. Cases of financial misconduct which constitute a crime committed by officials were not always reported to the South African Police Service, as required by section 10(1) of the *Municipal regulations on financial misconduct* procedures and criminal proceedings.

## Internal control

47. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

## Leadership

48. There was no effective review of the financial statements and the annual performance report, resulting in several material misstatements being identified.
49. The accounting officer did not implement effective processes to ensure that the municipality has adequate and sufficiently skilled resources and that unauthorised, irregular and fruitless and wasteful expenditure is prevented.
50. The action plan developed by the municipality to address internal and external audit findings did not adequately address the root causes to ensure that matters raised do not recur.
51. Unauthorised, irregular and fruitless and wasteful expenditure was not prevented and investigated to determine if any person is liable for the expenditure.

## **Financial and performance management**

52. The financial statements and other information to be included in the annual report are not adequately reviewed for accuracy and completeness by the accounting officer.
53. The municipality does not have adequate skills in the finance unit resulting in over reliance on external consultants for financial reporting functions.
54. Controls over compliance with laws and regulations, daily and monthly processing and reconciling of transactions were not adequately monitored by the accounting officer.

## **Governance**

55. The municipality's annual risk assessment report for the year was only approved on 25 May 2016, this was too late to facilitate risk prioritisation for the year, risk monitoring and also to inform the internal audit plan.
56. The internal audit unit could not complete all the planned audits and fulfil all of its responsibilities due to understaffing for the greater part of the year.
57. The effectiveness of the audit committee was affected by the understaffing of the internal audit unit for the greater part of the year and late submission of financial and performance reports for review.

## **Other reports**

58. I draw attention to the following engagements that could potentially impact on the municipality's financial, performance and compliance related matters. My opinion is not modified in respect of these engagements that are either in progress or have been completed.

## **Investigations**

59. Investigations were performed internally on three officials in connection with misconduct. The investigations were finalised with the officials being warned and two being further suspended for nine days without remuneration.

*Auditor-General*

Auditor-General

Polokwane

30 November 2016

